

Qualification; private foundation; governing instrument provision; dissolution requirements. Provisions in an organization's governing instrument that satisfy the requirements of section 508(e) of the Code, for purposes of qualification for exemption under section 501(a) as a private foundation, are not in themselves sufficient to meet the requirement of section 1.501(c)(3)-1(b)(4) of the regulations that, upon dissolution, the organization's assets be dedicated to an exempt purpose.

ISSUE

Does an organization that would be classified as a private foundation if it were described in section 501(c)(3) of the Internal Revenue Code, satisfy the organizational test set forth in section 1.501(c)(3)-1(b)(4) of the Income Tax Regulations by virtue of having satisfied the governing instrument provision of section 508(e)?

FACTS

M seeks recognition of exemption under section 501(c)(3) of the Code and is an organization that would, if described in section 501(c)(3), be classified as a private foundation within the meaning of section 509(a). M does not have a provision in its articles of incorporation requiring the distribution of its assets for charitable purposes upon dissolution. The state nonprofit statute under which M incorporated has not been construed to operate in a manner that assures dedication of assets to charitable purposes. However, M's state of incorporation does have a statute that imposes the requirements of section 508(e) on all private foundations formed in that state, in accordance with section 1.508-3(d) of the Income Tax Regulations. See Rev. Rul. 75-38, 1975-1 C.B. 161, which lists those states that have been held by the Service to have adopted legislation satisfying the requirements of section 508(e).

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that:

DISTRIBUTION OF ASSETS ON DISSOLUTION. An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the federal government, or to a State or local government, for a public

purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.

Section 508(e) of the Code provides that a private foundation shall not be exempt from taxation under section 501(a) unless its governing instrument provides that it distribute its income annually to avoid tax under section 4942, not engage in any act of self-dealing as defined in section 4941(d), not retain any excess business holdings as defined in section 4943(c), not make any jeopardizing investments resulting in tax under section 4944, and not make any taxable expenditures as defined in section 4945(d).

Section 1.50803(d) (1) of the regulations provides that:

EFFECT OF STATE LAW-IN GENERAL. A private foundation's governing instrument shall be deemed to conform with the requirements of paragraph (a) of this section if valid provisions of State law have been enacted which:

(i) Require it to act or refrain from acting so as not to subject the foundation to the taxes imposed by section 4941 (relating to taxes on self-dealing), 4942 (relating to taxes on failure to distribute income), 4943 (relating to taxes on excess business holdings), 4944 (relating to taxes on investments which jeopardize charitable purpose), and 4945 (relating to taxable expenditures); or

(ii) Treat the required provisions as contained in the foundation's governing instrument.

Section 508(e) of the Code applies only to a private foundation. Section 509(a) defines the term private foundation as an 'organization described in section 501(c)(3)' An organization that does not meet the requirements of section 1.501(c)(3)-1(b)(4) of the regulations as to dissolution is not 'described in section 501(c)(3).'

The legislative history of sections 508(e) and 509(a) of the Code makes it clear that the requirements set out in section 508(e) are additional to those found in section 501(c)(3). For example, see H.R. Rep. No. 91-413 (Part I), Committee Report to accompany the Tax Reform Act of 1969, 91st Cong., 1st Sess. 40 (1969), 1969-3 C.B. 200, 226, which, in regard to 'effective assurance . . . that the assets and organizational structure dedicated to charity will in fact be used for charity,' states that:

the bill provides as an ADDITIONAL CONDITION OF EXEMPTION FOR

PRIVATE FOUNDATIONS the requirement that the governing instrument require current distributions of income (sec. 4942) and prohibit self-dealing (sec. 4941), retention of excess business holdings (sec. 4943), speculative investments (sec. 4944), and taxable expenditures Your committee intends and expects that this requirement will add to the enforcement tools available to State officials charged with supervision of charitable organizations. (emphasis added.)

See also S. Rep. No. 91-552, 91st Cong., 1st Sess. 56 (1969), 1969-3 C.B. 423, 460.

HOLDING

M does not satisfy the organizational test with respect to dissolution requirements set forth in section 1.501(c)(3)-1(b)(4) of the regulations, by virtue of satisfying the governing instrument provisions applicable to private foundations under section 508(e).

This revenue ruling does not apply to nonexempt charitable trusts that are private foundations by virtue of section 4947(a)(1) because section 4947(a)(1) treats them as described in section 501(c)(3) regardless of the dissolution provision.

Internal Revenue Service